

Financing the future

Two proposals: to simplify co-funding negotiations and to improve spin-off and involvement of SMEs

When trying to cooperate in defence, project funding is always **the** prime issue. Technological issues and project coordination are usually complex but can be solved between industries and governments.

Past projects have proven that synchronisation of the necessary national budgets is always troublesome. It is hard to arrange for the availability of money at the right time, right location and in sufficient amounts. As a result, it often takes years of negotiations to establish a suitable project budget. When a Government falls, or elections occur in a participating nation, negotiations often stall or have to start over.

The creation of the European Defence Fund will help to solve funding issues, but as long as national co-financing is required, a few obstacles will remain on the road.

- (1) The first obstacle I would like to mention is that national rules usually preclude the use of taxpayers' money outside their nation. Funds cannot be used to pay an industry operating in another nation. Even when the capabilities of this industry are important from a technical perspective or cost-efficient in the project.
- (2) The second obstacle to be mentioned is, that the availability of funds from co-funding nations often occurs in other budget years than required in a logical project schedule. This leads to sub-optimal planning and work performed in industries less capable or less economically attractive for a particular project part.

The lengthy negotiation process to solve these issues often takes many months and sometimes years to reach a suitable solution. Often development items are minimised to fit the budget available for a specific industry, and the important element of potential dual use in other sectors of the economy is left out to save time and money.

The creation of the EDF and other new policies will be an incentive to work even harder and try to find solutions, but some underlying complex national issues as mentioned have not been solved. Particularly not when 80% national co-funding is required for a project.

As the total amount of available money and the intention to cooperate is often **not** an issue, I would like to present two suggestions to use funds from the financial market to ease negotiations and to stimulate dual use as well as participation of SMEs.

Suggestion 1

Temporary use of private funds could simplify budgeting issues in defence capability cooperation

This suggestion could be used in EDF projects, but also for PESCO and regular EDA category A and B projects.

Please consider this simplified example: Several member states participating in a project have co-funding available except for one nation that has their funding available two or three years later than the others. It is however essential that an industry in that particular nation participates in the first stage of the design. Currently this would be a reason to delay the start of the project until the funding from that nation becomes available.

However, there would no reason to wait if the funds could be borrowed temporarily on the financial market. This could be done by the industry involved on a guarantee from the Member State to repay the loan as soon as the co-funding becomes available. A simple transaction with a very low risk.

In more complex projects a so-called Special Purpose legal Entity (SPE) could be established to facilitate temporary loans as required. During the course of the project the national funds are used to pay off these loans. At the end of the project the balance for the private funder is zero. Risk for the private funder is very low, because at the start of the project each participating nation can guarantee the availability of funds in a particular year. This means the interest rate for the private funding will also be very low.

Funds could be borrowed from regular private banks in Europe. It would be even better if the European investment Bank (EIB) could be involved. This, however, requires their ban on participation in defence-related activities to be lifted.

Suggestion 2

Private funds used for defence related R&D could reduce budget needs and stimulate the economy

European and national defence policies often state that defence related R&D is of great benefit for the general economy. Spin-off technologies supposedly stimulate development of products for use in other sectors of society. In practice however, government funds for defence R&D focus on military use of technologies and products only. Use of government funds to develop commercial products is not allowed, and industries usually do not receive a practical business incentive to use new technologies for spin off products. Consequence is that it usually takes many years for spin-off technologies of European defence R&D to occur into our daily lives. If ever.

If the policy of benefit from defence R&D for the general economy should become true, it would be wise to broaden the focus of R&D activities and immediately include development of spin-off products while developing a product for military use.

Both lines of development could mutually benefit from prototyping and testing phases, as well as from economy of scale in production.

This broader focus and additional work does not need to be funded by government. Private capital would be interested when the government acts as development lead and launching customer. In such case, risk is low for the private funder. Since 2014 a European directive is in force that allows for long term innovation partnership contracts. This directive (2014/24/EU) is particularly suitable for this type of broadened R&D.

The use of private money in R&D could also allow for participation of SMEs and industries from nations that do not have considerable R&D budgets.

As a closing remark, I suggest to incorporate the use of private funds for defence applications in the ecosystem of the defence sector. Take away the walls between government funds and private funds where possible, to ease defence project realisation and to stimulate spin-off to other sectors of the economy.

In modern economy, almost no user organisation invests large amounts of money upfront in costly capabilities. Pay for use is the rule, and this rule could be effective in the defence sector as well.